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MEMORANDUM

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TO: Docket Control Center

2015 NOV 16 A 10:19

FROM: Thomas M. Broderick
for Director
Utilities Division

AZ CORP COMMISSION
DOCKET CONTROL

DATE: November 16, 2015

RE: STAFF REPORT FOR ARROYO WATER COMPANY, INC.'S EMERGENCY
RATE APPLICATION (DOCKET NO. W-04286A-15-0339)

Attached is the Staff Report for Arroyo Water Company, Inc.'s ("Arroyo" or "Company") Emergency Rate Application. Staff recommends approval of Staff's alternative emergency rate increase.

Any interested party wishing to file comments regarding the attached Staff Report may file those comments with the Arizona Corporation Commission's Docket Control no later than November 30, 2015.

TMB:MJR:red/BH

Originator: Mary J. Rimback

Arizona Corporation Commission

DOCKETED

NOV 16 2015

DOCKETED BY	
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Service List for Arroyo Water Company, Inc.
Docket No. W-04286A-15-0339

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

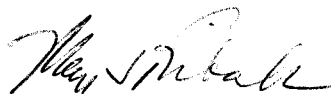
**ARROYO WATER COMPANY, INC.
DOCKET NO. W-04286A-15-0339**

**APPLICATION FOR AN
EMERGENCY RATE INCREASE**

NOVEMBER 16, 2015

STAFF ACKNOWLEDGMENT

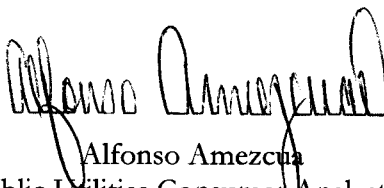
The Staff Report for Arroyo Water Company, Inc. ("Company"), Docket No. W-04286A-15-0339 was the responsibility of the Staff members listed below. Mary J. Rimback was responsible for the review and analysis of the Company's application, recommended revenue requirements, and rate design. Frank Smaila was responsible for the engineering and technical analysis. Alfonso Amezcua was responsible for reviewing the Commission's records on the Company and reviewing customer complaints filed with the Commission.



Mary J. Rimback
Public Utilities Analyst



Frank Smaila
Utilities Engineer - Water/Wastewater



Alfonso Amezcua
Public Utilities Consumer Analyst II

EXECUTIVE SUMMARY
ARROYO WATER COMPANY, INC.
DOCKET NO. W-04286A-15-0339

Arroyo Water Company, Inc. ("Company") is located in an area located in the community known as Tonto Basin, approximately 25 miles south of Payson in Gila County, Arizona. The Company provides water utility services to approximately 122 residential customers.

The Company is requesting an emergency rate increase in the amount of \$72,000¹, or a 158.14 percent increase over the Company's represented 2014 revenue of \$45,528². Staff recommends an emergency rate increase in the amount of \$16,402, or a 51.50 percent increase over Staff adjusted 2014 revenues of \$31,846.³

Staff Recommendations:

Staff recommends approval of an emergency interim rate surcharge of \$11.20 per connection per month.

Staff further recommends that the rates approved in this case will be interim, and subject to refund until permanent rates are established in the next rate case filing.

Staff further recommends that no change to commodity charges, miscellaneous service charges, and service and meter installation charges be approved.

Staff recommends that proof of property taxes paid be submitted semi-annually until the obligation is paid in full. The Company is six years delinquent and Staff has included funding in emergency rates to pay these past due taxes.

Staff further recommends that the Company be ordered to obtain a bond or an Irrevocable Standby Letter of Credit in the amount of \$10.00.

Staff further recommends that the Company be ordered to file a full rate case application no later than 24 months after the effective date of the interim emergency rates, using the most recent test year data reasonably available.

Staff further recommends that the Company maintain records as required for a permanent rate application, including details of water usage, copies of all invoices and other cost documentation supporting the rates requested.

¹ Page 4 of Emergency Rate Application.

² Page 16 of Emergency rate Application.

³ Staff requested details of 2014 revenues and expenses as discussed in the "Staff Review" section of this report.

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INTRODUCTION

On September 28, 2015, Arroyo Water Company, Inc. ("Arroyo" or "Company") filed an application for an emergency rate increase (Matter No. 15-0339) with the Arizona Corporation Commission ("Commission"). Concurrently the Company filed an "Application for Approval of the Sale of Assets and/or Transfer of Certificate of Convenience and Necessity" (Matter No. 15-0340).

On October 15, 2015, a Procedural Conference was held on the applications of Arroyo Water Company, Inc. and Jakes Corner Water Systems for approval of an emergency rate increase (Docket Nos. W-20935A-15-0338 and W-04286A-15-0339). At the conference November 16, 2015, was set as the docket date for a Staff Report and December 7, 2015, as the date for the hearing on both applications.

Also at the conference on October 15, 2015, there was a discussion as to the probable transfer of Arroyo's current matters to Docket No. W-04286A. A subsequent Pleading by Staff Attorney on October 22, 2015 recommended this transfer and a Procedural Order on November 3, 2015 granted this request.

The Company stated in its application that the Company is insolvent and that the system has immediate emergencies. At page 8 of the application is Company provided a list of system repairs necessary to alleviate the emergency condition and on the same page, the Company stated that no estimate of costs is available at this time.

At page 9 of the application, the Company included an annual report for the system for the year ending December 31, 2014. The Annual report represented that for the twelve months of 2014 it received revenues of \$45,528, and paid expenses of \$52,317⁴ for an operating loss of \$6,789. The Company requested an emergency rate increase of \$72,000 on page 4 and page 7 of the application. The \$72,000 increase is a 158.14 percent increase over the Company represented 2014 revenue of \$45,528.

BACKGROUND

Arroyo is an Arizona Class E utility engaged in the business of providing potable water service to approximately 122 customers in a community known as Tonto Basin, approximately 25 miles south of Payson, in Gila County, Arizona. The Company representative Michael Armstead, stated in a procedural conference on October 15, that Management Systems, LLC purchased Arroyo on July 1, 2015. On September 28, 2015, an application to transfer the Certificate of Convenience and Necessity ("CC&N") from Arroyo Water Company, Inc. to Management Systems, LLC was docketed with the Commission (Docket No. 04286A-15-0340). No decision on the transfer of CC&N has been issued at the time of issuance of this Staff Report.

⁴ The itemized expenses did not mathematically compute to this amount.

ENGINEERING ANALYSIS

The Staff Engineering Memorandum is attached to this report. In the Memorandum, Staff discusses the lack of reliable data for the system. Staff notes that the Company does not have an approved Backflow Prevention Tariff.

CONSUMER SERVICES

The Corporations Division of the Commission indicates that Arroyo is currently in good standing.

A review of the Consumer Services section records for the period of January 1, 2012 through October 7, 2015, reflects no complaints or opinions.

COMPLIANCE

Arroyo has no Commission outstanding compliance issues pending.

CONDITIONS NECESSARY FOR EMERGENCY RATE RELIEF

General conditions necessary for interim emergency rates⁵ include:

1. A sudden change that causes hardship to a company.
2. A company is insolvent.
3. A company's ability to maintain service (pending a formal rate determination) is in serious doubt.

STAFF REVIEW

The Company's application, on page 4 and 7 requests emergency rates of an additional \$72,000. A list of plant items needing repair or replacement appears on page 8 of the application. However, no specific costs are attached to the items listed. The items on the list are long-lived plant items. Staff concludes that the proposed level of increase is intended to provide for the cost of long-lived additions or replacements to plant, rather than the on-going operational needs of the Company.

Due to the long-term nature of this investment, Staff believes this would more appropriately be funded through long-term financing. Staff expects the Company to file a formal financing application for these expenditures. The need for the long-term investment and the rate impact can

⁵ According to Attorney General Opinion No. 71-17, interim or emergency rates are proper when either all or any of the following conditions occur: when sudden change brings hardship to a Company; when the Company is insolvent; or when the condition of the Company is such that its ability to maintain service pending a formal rate determination is in serious doubt. Those criteria have been affirmed in *Scates v. Arizona Corporation Commission*, 118 Ariz. 531 (CT. App. 1978) and in *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz. 588 (2001).

be evaluated at that time. Logically, this could be done in consolidation with the full rate application as recommended by Staff.

As noted, Staff does not consider the requested emergency increase of \$72,000 to be reasonable because:

- 1) An increase of the magnitude proposed by the Company would increase the monthly bill per customer per month by \$49.00 ($\$72,000/12 = \$6,000$; $\$6,000/122 = \49.00);
- 2) The cost of funding the long-lived assets that are included with the Company's request are appropriately spread over many years, as in a financing; and
- 3) The emergency rate increase should only address current operational needs.

Staff has determined that the Company is operationally insolvent. The last rates were set in September of 1991, and the Company is delinquent in its property taxes back to 2008 in the application for transfer of the CC&N. The Company application provided little information as to the revenues and expenses to be included in the emergency rates, other than the net operating loss of \$6,789.

Nor can the Company's annual reports be relied upon for this information. No annual reports have been filed since 2007 by the Company. The earlier Annual Reports provided with the application are signed by Kacy Parker, the previous owner of the Company. Staff requested additional information and was provided a print-out on October 22, 2015, showing details of the 2014 transactions for Arroyo. The print out was titled "Profit & Loss Detail January through December 2014". Details included the dates and names of the transactions.

The Company's 2014 annual report shows revenues of \$45,528.48; the Detailed Report shows revenues of \$40,607.67⁶. The annual report shows expenses of \$52,317.87; the Detailed Report shows expenses of \$10,756.43. The annual report shows an operating loss of \$6,789.39; the detailed report shows a net income of \$29,851.24. As the Annual Reports contained no detailed amounts, Staff concludes that the Detailed Report showing dates and names was a more accurate indicator of the 2014 revenues and expenses.

Staff, therefore, concludes the detailed report is a more reliable indicator of the Company's operational needs. While there are considerable differences in the amounts shown in the application versus the amounts on the Detailed Report of transactions, Staff notes that a number of usual expenses were not included in the expense details. The ten categories of expense which were shown in the details are:

⁶ Staff notes sales taxes of \$2,947 and meter installation charges of \$5,815, are included in revenues. Staff removed sales taxes from both revenues and expenses. Staff remove meter installation revenues from metered revenue. Staff Adjusted metered revenue is \$31,846.

Bank Service Charges	\$	146.00
Contract Labor	\$	2,533.50
Materials	\$	94.50
Postage and Delivery	\$	692.00
Repairs	\$	(1,875.45)
Supplies	\$	25.00
State Sales Tax	\$	2,706.04
Technical Support	\$	121.51
Gas and Electric	\$	4,978.33
Water Testing	\$	1,335.00
	\$	<u>10,756.43</u>

Scant information was provided to Staff as to the historical operational expenses of the Company. Staff has determined estimates for known on-going expenses as follows:

Purchased Power	\$	5,000
Chemicals	\$	100
Repairs and Maintenance	\$	6,100
Office Supplies and Expense	\$	1,464
Outside Services	\$	12,000
Water Testing	\$	1,030
Rents & Telephone	\$	7,200
Transportation Expense	\$	1,200
One-half of past due property taxes	\$	6,371
Property Taxes	\$	<u>1,783</u>
Subtotal	\$	42,248
Additional cash flow	\$	6,000
Total Expenses	\$	48,248
Less Current Revenues	\$	(31,846)
Additional Funding	\$	16,402

Based on this information, Staff concludes that the Company does require emergency rate relief in order to provide for on-going operating expenses. However, to the extent the Company's request includes capital plant items, these would be better addressed in a financing application, which would allow the cost of long-lived assets to be spread over the life of the assets.

Staff estimates an emergency increase of revenues in the amount of \$16,402 is required. This reflects an increase of 51.50 percent over Staff adjusted revenues of \$31,846. Staff recommends an interim surcharge amount of \$11.20 per customer per month (\$16,402/1,464 bills). Staff recommends emergency interim rates that produce sufficient revenue to cover operating and maintenance expense and to manage contingencies. Staff does not recommend tiered rates as proposed by the Company. Tiered rates require water usage data by tiers. Instead, Staff calculated an interim increase in a fixed monthly amount. This will allow the Company a predictable cash flow.

Normal emergency rate case procedures require that the Company provide a bond sufficient to cover a refund of the interim rates approved in this case. If it is later determined that the

emergency rate increase was not necessary or only partially necessary, the bond will facilitate the refunding of the interim rates to ratepayers. Staff does not believe the entire amount of the emergency rate increase needs be covered by a bond in this instance. Staff recommends that a bond or an Irrevocable Standby Letter of Credit be required in the amount of \$10.00.

Normal emergency rate case procedures require that the Company be ordered to file a full rate case application within a reasonable period after interim rates are awarded in the case. Staff recommends that the Company be ordered to file a full rate case application no later than 24 months after the effective date of the emergency interim rates, using the most recent test year.

RATE DESIGN

Rate design is critical to the Company's ability to collect revenues to cover operational expenses. The design of rates normally would include a historical bill count, which calculates water usage at various tiers of water usage. Bill counts are not required in filing an interim emergency rate application. Pages 4 and 5 of the Company's Emergency rate application proposed inverted three tiered commodity rates; however without bill counts showing the tiered amounts of water usage, there is no predictability to the revenue generated by the Company's rate design.

Staff recommends that the emergency rates be generated from an emergency interim surcharge until the Company is able to file for permanent rates. Staff recommends that all other present tariffs remain as currently tariffed approved.

STAFF RECOMMENDATIONS

Staff recommends approval of an emergency interim rate surcharge of \$11.20 per connection per month.

Staff further recommends that the rates approved in this case will be interim, and subject to refund until permanent rates are established in the next rate case filing.

Staff further recommends that no change to commodity charges, miscellaneous service charges, and service and meter installation charges be approved.

Staff recommends that proof of property taxes paid be submitted semi-annually until the obligation is paid in full. The Company is six years delinquent and Staff has included funding in emergency rates to pay these past due taxes.

Staff further recommends that the Company be ordered to obtain a bond or an Irrevocable Standby Letter of Credit in the amount of \$10.00.


Staff further recommends that the Company be ordered to file a full rate case application no later than 24 months after the effective date of the interim emergency rates, using the most recent test year data reasonably available.

Staff further recommends that the Company maintain records as required for a permanent rate application, including details of water usage, copies of all invoices and other cost documentation supporting the rates requested.

MEMORANDUM

DATE: October 27, 2015

TO: Mary Rimback
Public Utilities Analyst

FROM: Frank M. Smaila 
Utilities Engineer

RE: Arroyo Water Company, Inc. Emergency Rate Increase Application
Docket No. W-04286A-15-0339

INTRODUCTION

On September 28, 2015, Arroyo Water Company, Inc. ("Arroyo" or "Company") filed with the Arizona Corporation Commission ("ACC") an application for approval of an emergency rate increase. The plant facilities were field inspected on October 22, 2015, by Utilities Division Staff ("Utilities Staff" or "Staff") Lori Miller, Mary Rimback and Frank Smaila in the accompaniment of Mr. Michael Armstead, water system owner.¹

The Company is providing service to approximately 122 customers in an area located in the community known as Tonto Basin, approximately 25 miles south of Payson in Gila County. Figure 1 shows the location of the Company within Gila County and Figure 2 shows the location of the Company in relation to other Commission regulated companies in Gila County. The Certificate of Convenience and Necessity area covers approximately 1,925 acres (approximately three square mile).

WATER SYSTEM²*Operation*

The Company's water system includes one well which contains two well pumps of 3 and 5 horsepower ("hp") with combined estimated yield of 90 gallon per minute ("gpm"), one 11,000 gallon storage tank, three booster pumps (5, 5 & 15 hp), one 2,500 gallon pressure tank and a distribution system. There is one-two inch master meter located downstream of the storage tank. A system schematic is shown as Figure 3.

Capacity

Based on the Company's 2014 water use data, the Company reported the peak use month as July with 1,451,502 gallons sold, averaging 378 gallons per day ("gpd") per connection. Staff concludes that the current well, operating at the reported capacity of 90 gpm, could adequately serve the present customer base and reasonable growth. Based on the Company's 2014 water use data

¹ Mr. Armstead stated that he purchased the water system on July 1, 2015.

² Per Company's responses to Staff's Insufficiency letter in Docket No. W-20935A-15-0260

and capacity analyses for a two well pump system, no minimum storage is required on this system to meet seasonal peak demand. However, the current storage tank has an obvious leak at the tank bottom and the well meter is located downstream of the storage tank. Since the water loss from the leaking storage tank is unknown, the actual well production is unknown and the system's water loss cannot be determined. Staff recommends that the Company install a two inch master meter between the well pump and inlet to the storage tank in order to calculate water loss. Staff's estimated cost for the purchase and installation of a new two inch master meter is \$2,000.

ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY ("ADEQ") COMPLIANCE

According to an ADEQ Compliance Status Report, dated October 2, 2015, ADEQ has reported no major deficiencies and has determined that the Company's system, Public Water System ("PWS") No. 04-083, is currently delivering water that meets water quality standards required by 40 CFR 141/Arizona Administrative Code, Title 18, Chapter 4.

ARIZONA DEPARTMENT OF WATER RESOURCES ("ADWR") COMPLIANCE

The Company's water system is not located in an ADWR Active Management Area. According to an ADWR compliance status report dated October 13, 2015, ADWR has determined that the Company's water system is not in compliance with ADWR requirements, as the Company failed to file its Annual reports and the System Water Plan.

ACC COMPLIANCE

On October 21, 2015, the Utilities Division Compliance Section stated that a check of the compliance database indicates that there are currently no delinquent compliance items for the Company.

CURTAILMENT TARIFF

The Company has an approved curtailment tariff on file with an effective date of August 1, 2007.

BACKFLOW PREVENTION TARIFF

The Company does not have an approved Backflow Prevention Tariff.

RECOMMENDATIONS

1. Staff recommends that the Company file with Docket Control within 90 days of the effective date of the order in this proceeding, as a compliance item in this docket, documentation demonstrating that a wellhead meter has been installed between the well pump and inlet to the storage tank.